

GOVERNMENT PROPOSED JURY INST. NO. 259

Expenditures Method of Proof

*Theory*

The government has introduced evidence of the expenditures method of proof to establish that the taxable income reported by the defendant on his [her] income tax returns is not true and correct. By this method, the government seeks to establish that the defendant **1** spent an amount greater than the amount reported on his [her] income tax returns as being available for spending. In other words, the government claims that the defendant could not have spent the amount that he [she] did in a given year unless he [she] had more income than the defendant reported on his [her] return for that year.

***[In this case, the defendant is married, and is charged with filing false joint income tax returns for the defendant and his [her] spouse. The government accordingly has introduced evidence purporting to reflect their joint expenditures.] 1***

Under this method, the first step is to add up and total the amounts that the defendant spent during a given year. The next step is to subtract from the total amount spent: (1) any funds that the defendant had on hand at the beginning of the year which were spent during the year; (2) any monies received by a conversion into cash of assets that were on hand at the beginning of the year; and (3) any nontaxable funds received during the year.

The government claims that a reasonable approximation of the taxable income the defendant should have reported is the amount remaining after personal deductions, exemptions, and adjustments are subtracted from the defendant's income computed on the basis I have just explained to you.

***Opening Net Worth***

Now, I want to go over some of the points I have just mentioned. As I previously said, under the expenditures method you subtract from the total amount spent any funds the defendant had on hand at the beginning of the year and any monies received by converting into cash assets that were on hand at the beginning of the year. Another way of saying this is that a starting point or opening

net worth must be established so that the defendant is not improperly charged with spending which only reflects what he [she] earned or had from prior years.

You will readily appreciate that if the defendant actually owned substantial assets at the beginning point which the government has failed to consider in its computations, apparent spending of income during the indictment years may be no more than the disclosure of money previously saved, or the result of a conversion into cash of assets which the defendant owned at the beginning of the year.

For example, a taxpayer might have had a substantial amount of cash on hand which he [she] had saved up in prior years and used to make purchases or other expenditures during a prosecution year. In that case an apparent spending out of income during the year might be only the result of spending money earned in a prior year. You must, therefore, be satisfied that the government's evidence establishes that the defendant has been given credit for any cash on hand that he [she] had as well as for any cash realized from the conversion into cash of assets that he [she] had on hand.

On the other hand, the government is not required to refute all possible speculation that the defendant might have converted into cash assets that he [she] had at the beginning of the year which the investigation failed to disclose; nor is it necessary for the government to prove the precise amount of cash on hand that the defendant had at the beginning of the year. It is enough if the government can show beyond a reasonable doubt that cash on hand and the conversion of assets into cash do not account for the expenditures of the defendant during the taxable year.

The burden rests originally upon the government, and the burden remains upon the government, to establish an opening net worth with reasonable certainty.

In this case, the government has endeavored to prove that the defendant did not have any cash on hand or assets at the beginning of the year which he [she] later converted into cash, other than those disclosed as a result of its investigation by, among other things, tracing the financial history of the defendant. The evidence introduced by the government of the defendant's [*income tax return(s) and*] financial history in years prior to those named in the indictment may be considered by you for such light as it may shed on the innocence or guilt of the defendant during the years named in the

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indictment.

In determining whether or not the opening net worth is reasonably accurate, you may consider whether the government has tracked down "reasonable leads" or explanations, if any, suggested to the government by the defendant (or his representative) during the investigation which tend to establish the defendant's innocence.

If you are satisfied that any such reasonable leads and explanations have been exhausted or refuted, then this would be evidence which you could consider in determining whether the opening net worth relied on by the government is reasonably accurate. Obviously, improbable explanations would not be entitled to as much weight as plausible and reasonable explanations. If you should find that the government's investigation has failed to refute what seem to you to be plausible explanations, such failure may be considered by you in determining the validity of the opening net worth.

If you find that the government has not established the opening net worth of the defendant to a reasonable certainty as of the beginning of any year named in the indictment, then you will find that the defendant is not guilty for any such year of reporting a taxable income that is not true and correct.

If you find as to any year that the funds spent by the defendant are not substantially in excess of the taxable income reported by the defendant on his [her] return for that year, or if you have a reasonable doubt as to whether such funds are substantially in excess of reported taxable income, then you will find that the defendant is not guilty for any such year of reporting a taxable income that is not true and correct.

If you find, on the other hand, that the government has established the net worth of the defendant to a reasonable certainty as of the beginning of any year named in the indictment, and if you are also convinced beyond a reasonable doubt that the expenditures established by the government during such year are substantially in excess of the income reported on the defendant's tax return, then you will proceed to inquire whether the government has established that those funds represented income.

***Current Taxable Income***

The burden is on the government to establish beyond a reasonable doubt that the funds reflected in the defendant's expenditures arose from taxable, rather than nontaxable sources.

In this connection, I charge you that the federal income tax is levied on gains, profits, and income derived from salaries, wages, or compensation for personal services, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property; also from interest, rent, dividends, securities, or the transaction of any business, *[legal or illegal]*, carried on for gain or profit, or gains or profits and income derived from any source whatever.

The law states, however, that certain kinds of funds do not constitute income. Since no income tax is levied on such funds they need not and should not be reported as income. These funds include gifts, inheritances, proceeds of loans, and certain other miscellaneous items which are not pertinent here.

As I have previously stated, the burden rests upon the government to prove beyond a reasonable doubt that the funds reflected in the defendant's expenditures arose from a taxable source or sources, or that the funds did not come from nontaxable sources. In other words, expenditures alone do not establish the receipt of taxable income unless the evidence shows either: (1) a likely source of income from which you believe they sprang; or (2) that the government has established that the defendant did not have a nontaxable source of income which accounts for the expenditures.

If you find that the defendant offered timely explanations of the source of his [her] funds, which were reasonably susceptible of being checked, the government may not disregard them; and you may take into consideration any failure by the government to run down such explanations, if any were made, or the results of any investigation made by the government into the truth of the explanations. On the other hand, where relevant leads are not forthcoming, the government is not required to negate every conceivable source of nontaxable funds, and if the defendant failed to supply information in that regard, you may take such failure into account. The defendant is not required, however, to provide any explanations or to prove the source of his [her] funds, for, as I have said,

the burden is on the government to prove that the funds used for expenditures arose from taxable sources.

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This instruction is based on the rationale of the courts in the following decisions:

***Taglianetti v. United States***, 398 F.2d 558, 562 (1st Cir. 1968), *aff'd.*, 394 U.S. 315 (1969)

***United States v. Citron***, 783 F.2d 307, 315 (2d Cir. 1986)

***United States v. Breger***, 616 F.2d 634, 635 (2d Cir.), *cert. denied*, 446 U.S. 919 (1980)

***United States v. Marshall***, 557 F.2d 527, 529 (5th Cir. 1977)

***United States v. Newman***, 468 F.2d 791, 793 (5th Cir. 1972), *cert. denied*, 411 U.S. 905 (1973)

***United States v. Penosi***, 452 F.2d 217, 219 (5th Cir. 1971), *cert. denied*, 405 U.S. 1065 (1972)

***United States v. Caswell***, 825 F.2d 1228, 1231-32 (8th Cir. 1987)

***United States v. Pinto***, 838 F.2d 426, 431-32 (10th Cir. 1988)

The instruction is also based on the rationale of the following decisions involving the net worth method which is essentially the same as the expenditures method, ***Taglianetti v. United States***, 398 F.2d at 562:

***Holland v. United States***, 348 U.S. 121 (1954)

***Friedberg v. United States***, 348 U.S. 142 (1954)

***United States v. Calderon***, 348 U.S. 160 (1954)

***United States v. Massei***, 355 U.S. 595 (1957)

***United States v. Johnson***, 319 U.S. 503 (1942)

***United States v. Sorrentino***, 726 F.2d 876, 879, 880 (1st Cir. 1984)

***United States v. Breger***, 616 F.2d 634, 635 (2d Cir.), *cert. denied*, 446 U.S. 919 (1980)

***United States v. Terrell***, 754 F.2d 1139, 1144 (5th Cir.), *cert. denied*, 472 U.S. 1029 (1985)

***United States v. Schafer***, 580 F.2d 774, 775 (5th Cir.), *cert. denied*, 439 U.S. 970 (1978)

***United States v. Anderson***, 642 F.2d 281, 285 (9th Cir. 1981)

***NOTE***

**1** The instruction should be modified in those instances where a joint return is involved and also where the net worth computation reflects the joint net worth of a husband and wife, or, in rare instances, the joint net worth of a defendant and a third party.

GOVERNMENT PROPOSED JURY INST. NO. 265

Cash Expenditures Method

In this case the government relies upon the so-called "cash expenditures method" of proving unreported income. The theory of this method of proof is that if a taxpayer's expenditures and disbursements for a particular taxable year, together with any increase in net worth exceed the total of his reported income together with nontaxable receipts and available cash at the beginning of the year, then the taxpayer has understated his income.

The "cash expenditures method" necessarily involves not only the examination of the defendant's expenditures and disbursements during the taxable year, but also an examination of his "net worth" at the beginning and at the end of that year.

*[The remainder of this instruction should consist of the text of Offense Instruction No. 69.2, the "Net Worth Method," from the second paragraph to the end of that instruction.]* <sup>1</sup>

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*Pattern Jury Instructions, Criminal Cases*, Eleventh Circuit (1985 Ed.), Offense Instructions, Instruction No. 69.4, p. 236

**NOTE**

<sup>1</sup> Instruction No. 69.2 referred to above in the bracketed material is reproduced, *supra*, in the jury instructions on the net worth method.

GOVERNMENT PROPOSED JURY INST. NO. 266Cash Expenditures Method

To establish a substantial understatement of the tax on the income tax return of defendant \_\_\_\_\_ for the year[s] \_\_\_\_\_, the government has relied upon proof by the so-called "cash expenditures method" of determining income for that particular period. This "cash expenditures method", if done correctly, is an indirect or circumstantial way to reliably determine income.

In this method of proof, if a taxpayer's expenditures and disbursements for a particular taxable year, together with any increase in net worth, exceed the total of reported income together with non-taxable receipts for that same year and available cash at the beginning of the year, then the taxpayer has unreported income.

A person's net worth is the difference between a person's total assets and that person's total liabilities on any given date. Said another way, net worth is the difference between what a person owns and what that person owes at any particular time.

The "cash expenditures method" necessarily involves not only the examination of the defendant's expenditures and disbursements during the taxable year in question, but also an examination of the defendant's net worth at the beginning and again at the end of that year. <sup>1</sup>

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Devitt, Blackmar, & O'Malley, *Federal Jury Practice and Instructions*, (4th Ed. 1990), § 56.06, pp. 999-1000.

**NOTE**

**1** Notes following this jury instruction in Devitt, Blackmar, & O'Malley state that "The pertinent portions of the instruction on the "Net Worth Method", Section 56.05, should be given to the jury in conjunction with this instruction." Thus, the prosecutor should consult with the above net worth instructions, *supra*, for appropriate language to include. While the expenditures method is a "variant of the net worth method," there are certain different elements involved in their presentation, including



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the showing of net worth required. Under the expenditures method, "net worth need not be established by a formal net worth statement. Rather, accurate inclusion of diminution of resources serves the function of enabling the jurors to determine if expenditures were financed by liquidation of assets, depletion of a cash hoard, or unreported income." *United States v. Citron*, 783 F.2d 307, 315 (2d Cir. 1986); *See Taglianetti v. United States*, 398 F.2d 558, 562 (1st Cir. 1968), *aff'd*, 394 U.S. 316 (1969); *United States v. Caswell*, 825 F.2d 1228, 1232 (8th Cir. 1987); *United States v. Pinto*, 838 F.2d 426, 432 (10th Cir. 1988).